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C O N F I D E N T I A L SECTION 01 OF 03 BAGHDAD 001979

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SUBJECT: AMBASSADOR MEETS WITH NEW MINISTER OF OIL, HUSAYN
AL-SHAHRISTANI

REF: BAGHDAD 001552

Classified By: Ambassador Zalmay Khalilzad for reasons 1.4 (a) and (d).

¶1. (C) SUMMARY: On May 28, in his first meeting with the Ambassador as Minister of Oil, Husayn al-Shahristani outlined priorities for the oil sector and expressed the need for continued U.S. support. The new Minister also acknowledged the importance of inter-ministerial cooperation -- flagging the need for the Ministries of Oil, Electricity, Interior, and Defense to work together and with Multi-National Force-Iraq (MNF-I). Primary concerns expressed by the Ministry were infrastructure security and drafting of a hydrocarbon law that would invite international investment. Other priorities are fuel metering, rapid repair capacity, well workovers and completions, repair and maintenance for LPG facilities, and de-mining assistance from the U.S. The Minister stressed that he is serious about fuel import liberalization and subsidy reform, announcing that the IMF had granted a two-month extension for the next fuels price increase as agreed to under the Stand-By Arrangement (SBA). While relegating discussion of technical issues to his Deputy Ministers and hesitating to agree to weekly meetings with the Ambassador, the Minister emphasized his readiness to make decisions in his area of responsibility. END SUMMARY.

PROBLEMS WITH OIL PROGRAM AND
ROOM FOR IMPROVED COOPERATION

¶2. (C) During his May 28 call on newly appointed Oil Minister Husayn al-Shahristani, Ambassador expressed U.S. support for Iraqi efforts to boost oil production and referred to the \$1.7 billion U.S. program to revitalize the sector. Shahristani conveyed his appreciation for what the U.S. has done for Iraq, although he and the Deputy Ministers (DMs) present were somewhat critical of reconstruction efforts to date. Shahristani urged his Directors General (DGs) to be "frank" in their feedback since the Ambassador "is a friend." Contracting issues were discussed, including on key projects like the new 40-inch pipeline from Kirkuk to Bayji, as was the need for heightened cooperation among Iraqi partners. Shahristani acknowledged communications failures among the various state companies and the Ministry, noting that he would work to improve material support of U.S. contractors. Shahristani agreed that the recent arrest of the Director of the Northern Oil Company for providing equipment to a U.S. sub-contractor on the 40-inch line was an example of less than ideal communication. (NOTE: In the incident mentioned, the Embassy energetically intervened with the Commission on Public Integrity, former DPM Ahmad Chalabi, and a Mosul judge to secure the release of the oil official in question, after he undertook to lend specialized equipment to a U.S.

subcontractor at Embassy request. END NOTE.)

13. (C) Shahrستاني also cited the Kirkuk-Bayji export pipeline as an example of inadequate infrastructure protection, mentioning that it came up at the Cabinet meeting earlier in the day. Interdictions on the power lines along that corridor are affecting production, he added, as it limits the ability of the Bayji refinery (Iraq's largest) to deliver product to Baghdad. Emboffs asserted that security is improving after deployment of Strategic Infrastructure Battalions (SIBs), but Shahrستاني insisted that something must be wrong given continued interdictions and intimidation of workers. Shahrستاني conceded that cooperation with the U.S. has not always been at the needed level, recognizing that the security of pipelines and installations soon would need to be entirely the responsibility of the Iraqi armed forces. He added, however, that the Iraqi armed forces do not yet have the capacity to handle security on their own.

HYDROCARBON LAW AND LEARNING FROM KURDISH INITIATIVE

14. (C) Shahrستاني acknowledged that a hydrocarbon law is a top priority. He explained that upstream operations (such as exploration and production, exports and international oil company involvement) should be controlled at the federal level, and downstream operations (such as distribution and petrochemical production) should be open to privatization. Shahrستاني also stated that he had met with the Kurdish Minister of Natural Resources to discuss the Kurdish approach to resource development, and there seemed to be mutual agreement on the need for a comprehensive law to attract investment.

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TECHNICAL PRIORITIES AND WAYS FORWARD

15. (C) Shahrستاني then invited comment from the two DMs and one Director General present (Abdul Jabbar al-Awagga, DM for upstream and production; Muatassim Akram, DM for downstream distribution and refined product pipelines; and Fiadh Alfiad, DG for planning and studies). The priorities identified by these three were: infrastructure security, fuel metering, rapid repair capacity, completion of 60 planned well workovers, repair and maintenance for the Khor Zubayr LPG plant, and de-mining assistance from the U.S. to clear oil fields prior to exploration activities.

16. (C) During the discussion of these priorities, comments by DMs focused on assigning blame for project delays and failures to the U.S., to which Emboffs pointed out Iraqi responsibility in facilitating improvements in the oil sector. For instance, Emboffs explained, delays in executing a temporary shutdown to repair the Khor Zubayr LPG plant were due primarily to damaged replacement equipment, but have been exacerbated by a lack of capital and authority that could enable the North and South Oil Companies to feed wet gas to the plants.

17. (C) With regard to well workovers, Emboffs explained that delays have resulted from the inability of the contractor (Parsons) and the operator (Weatherford) to reach an agreement. However, they added, IRMO has been in discussion with the Ministry regarding whether joint efforts should go into workovers of wells in declining fields or completion of new wells.

18. (C) In addressing requests for de-mining support, Emboffs explained that the U.S. military is precluded from de-mining for non-military purposes. (NOTE: In performing assessments of subsurface resources, the "thumper" used in seismic studies can set off mines. END NOTE.) The DMs responded

that, although the Ministry of Planning is responsible for de-mining, a lack of experience in tendering and quality control has impeded the process of engaging a contractor for the work. The possibility of MNF-I building Iraqi military capacity to perform such work seemed a reasonable approach to both the Iraqis and Emboffs and will be further explored.

FUEL SUBSIDY REDUCTION AND LIBERALIZATION OF IMPORTS

¶9. (C) With regard to fuel price reform, Emboffs emphasized the importance of adhering to the IMF subsidy reduction schedule that would raise fuel prices to regional levels, thereby undermining the profitability of smuggling. (NOTE: Iraq has already failed to implement the March increase, and failure to meet the June increase could jeopardize the \$130 billion debt forgiveness package predicated on complying with the IMF SBA. END NOTE.) Shahrستاني said he is taking the subsidy issue seriously and has discussed the matter with the Finance Minister. Shahrستاني reported that the IMF, cognizant of the political ramifications of introducing higher fuel costs for the newly formed government, agreed to a postponement of "one or two months" before the next set of price hikes. (NOTE: Neither Shahrستاني nor any other official discussing this subject lately has ventured details on the size of the next set of price rises. END NOTE.)

¶10. (C) Shahrستاني affirmed that there is consensus within the government to support a measure on liberalization of imports. However, he added that before he champions policy reform, he needs to better understand the impact that liberalization will have on domestic fuel markets -- particularly the extent to which the imported fuel would be subject to diversion by black marketeers. Emboffs stated that an import liberalization plan had been delivered to former energy czar Ahmad Chalabi and that we are prepared to present it to him to revisit the issue. Kurdish DM of Distribution, Muatassim Akram, mentioned in a side conversation that the Kurdistan Regional Government (KRG) is experimenting with permitting importers to freely truck fuel in from Turkey for sale in the Kurdish north. Thus far, Akram said, the prices for these imports have been lower than those found on the black market. (COMMENT: As Akram acknowledged, this experiment is a great demonstration of how import liberalization could work and empirically support the case for broader fuel import liberalization in Iraq. END COMMENT.)

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NEXT STEPS

¶11. (C) Ambassador described how the crisis prompted by falling oil exports had led to the formation of the energy committee chaired by Chalabi. Both he and General Casey met weekly with Chalabi to discuss developments and challenges facing the energy sector. When Ambassador encouraged Shahrستاني to consider continuing these weekly meetings, Shahrستاني asked for a few days to consider the offer. However, given the existing high level of coordination with IRMO, it was agreed that weekly meetings at the DM-level should be held in addition to regular but less frequent senior-level staff meetings. Minister Shahrستاني insisted that any Emboffs should feel free to participate in these meetings.

COMMENTS

¶12. (C) COMMENT: Shahrستاني seemed very comfortable with his new position, but he left technical details to his DMs. According to others in the Ministry, thus far he has been

removed from Ministry personnel and operations; it is assumed that, as a new entrant to the oil field, he is trying to get up to speed before he asserts himself. However, Emboffs remain concerned that he will be as passive on key issues (such as fuel import liberalization) as he was as Deputy Speaker in Parliament. Shahrستاني is welcoming (and expectant) of U.S. assistance, but it is unclear how proactive he will be. In contrast to the lively initiative demonstrated by the new Minister of Electricity, Karim Wahid al-Hasan, at his introductory meeting the Ambassador on May 25, Shahrستاني's reserve left us with some doubt about his ability to help the new GOI stand on its own.

¶13. (C) COMMENT CONT'D: Shahrستاني stated his reliance on the U.S. to let him know when something is going wrong, and Emboffs assured him that any change in U.S. engagement will first be discussed with the Ministry. Perhaps compensating for his limited knowledge of the oil lsector, yet promising to take action when necessary, Shahrستاني repeatedly referred his having been given independent authority to approve contracts up to a certain (unspecified) amount. He said that he is willing to use that authority to resolve bottlenecks and facilitate projects to the extent possible, joking that "I have this authority. Let's use it before it is taken away!" END COMMENT.
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